COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

BAY STATE GAS COMPANY	)	**D.T.E. 05-27**

REPLY BRIEF OF
THE MASSACHUSETTS ATTORNEY GENERAL

Respectfully submitted,

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September 26, 2005

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I. INTRODUCTION

Pursuant to the procedural schedule issued by the Hearing Officer, the Attorney General files this Reply Brief to respond to arguments made by the Bay State Gas Company ("Bay State" or "Company") in its Initial Brief. This brief is not intended to respond to every argument made or position taken by the Company. Rather, it is intended to respond only to the extent necessary to assist the Department of Telecommunications and Energy ("Department") in its deliberations, i.e., to provide further information, to correct misstatements or misinterpretations, or to provide omitted context. Therefore, silence by the Attorney General in regard to any particular argument in another party's brief should not be interpreted as assent.

II. OVERVIEW

Hurricanes Katrina and Rita have caused significant direct damage to offshore rigs, refineries, pipelines, and ports in the Gulf of Mexico, which has resulted in major increases in energy prices, and it will take some time to recover from its effects. It is likely that customers will face extreme hardships paying winter heating bills. With the winter heating season almost upon us, and the Department faced with Bay State's request to increase its base rates by more than $22 million on December 1, 2005, now is not the time to further burden customers with rate increases attributable to poor management.

The base rate increase will be in addition to the November 1, 2005 increase in its gas cost adjustment factor by almost 50% over last November's rate. All Massachusetts gas utilities' gas costs will increase on November 1, but none will be higher than that proposed by Bay State Gas Company.[1] As reported by the Department to the Boston Globe recently, Bay State's average monthly bill will be the highest in the state based on the Company's currently effective rates. *See* Attachment "A," "Rate requests for natural gas utilities, proposed increases would take effect Nov. 1," Table, Boston Globe, September 21, 2005, p. D1.[2] For residential heating customers, the gas adjustment rate alone will increase a typical monthly winter bill of 150 therms by more than $70 and customers could likely see even higher gas costs this winter --yet there is no rate relief for them. At the same time, Bay State's customers have had to experience continued deterioration in Company's infrastructure, depletion of its workforce and compromised customer service and safety.

The Attorney General recommends that the Department reduce the Company's revenues by approximately $20 million, a reduction of the Company's proposal by approximately $42

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1 Last week the Company filed for a cost of gas adjustment factor of $1.49 per therm. *Bay State Gas* CGA filing, September 16, 2005. The other Massachusetts companies factors range from $1.26 *(Essex Gas Company* CGA filing, Sept. 16, 2005) to $1.47 per therm (*Fall River Gas Company* CGA filing, Sept. 16, 2005). Bay State's rate is 12 per cent higher than the average of the other local distribution companies ("LDCs"). It is not clear that the proposed rate is justified, given that Bay State's parent is a large, multi-state holding company that has many diverse interests in the natural gas industry. The Company touted this diversity and expertise when it claimed, at the time the merger, that there should be gas cost savings as the result of taking "advantage of economies and efficiencies relating to coordinated gas supply... more efficient use of NIPSCO Industries' storage facilities," among other factors. *Bay State Gas Company*, D.T.E. 98-31, p. 24 (1998).

2 The information contained in Attachment "A" was provided by the Department to the Boston Globe and appeared on Business Section page D-1 of the Boston Globe on September 21, 2005. The Attorney General requests that the Department take official notice and incorporate by reference its own information used to derive the Table. 220 C.M.R. § 1.10(2) ("the Department may take notice of general, technical, or scientific facts within its specialized knowledge"); 220 C.M.R. § 1.10(3) ("Any matter contained in any records ... in the possession of the Department ... shall be offered and made a part of the record in the proceeding.").

million.[3] Implementation of this general rate reduction on December 1 will provide some deserved financial relief to customers, although it will do nothing to reduce the commodity costs customers will be facing this winter.

In light of the Company's diminished reliability and quality of service, the Department should also immediately require an independent management audit of the Company. The scope of the audit should be well defined and should would focus on the safety and reliability of the Company's systems (what investments must be made and what is the most efficient procedures to produce the necessary results), customer service (what is the Company's actual performance, what should it be based on best practices, what do customers want and how should the Company proceed to fulfill the expectations) and be directed toward examining causes and identifying solutions to critical problems. Once the recommendations have been undertaken and improvements made, the Company can then seek rate relief.

III. THE DEPARTMENT SHOULD REJECT THE SIR PROGRAM, THE PENSION ADJUSTMENT MECHANISM AND THE PBR PLAN

A. ACCELERATING STEEL INFRASTRUCTURE REPLACEMENT AT CUSTOMER EXPENSE IS UNNECESSARY

The Department should reject the Company's plan for accelerated payment at customer expense under the Steel Infrastructure Replacement program because it is unnecessary, unjustified, and unsupported by the record evidence.

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[3] Bay State earned more than11.8 % return on their investment in 2003 and 10.5 % in 2004, more than the Department has allowed other Massachusetts gas utilities to earn. *See Boston Gas Company d/b/a KeySpan Energy Delivery New England*, D.T.E. 03-40, p. 364 (2003) (10.2 percent). A mismanaged company like Bay State with its management and quality service problems certainly should earn less than a gas utility that is efficiently and economically operated.

1. The Company Has Not Proven The Necessity Of Accelerated Replacement Of Its Entire Unprotected Steel Mains And Services Infrastructure At Customer Expense

Contrary to the Company's assertion, the Attorney General does not agree with the Company's steel infrastructure replacement ("SIR") plan's call for accelerated unprotected steel infrastructure replacement of its entire unprotected steel infrastructure. Co. I. Br., p. 26. The Company has not demonstrated that all of its unprotected steel mains and services require replacement on an expedited basis.[4] The Company has also not explored alternatives to the SIR, like the "safety first" approach advocated by Mr. Cavallo on a stepped-up basis, Tr. 17, pp. 2771-2773; Exh. DTE-AG-2-6, or a probabilistic approach to replacement by tracking main corrosion pitting, measuring soil conditions and other factors to target its replacement efforts as successfully used by the Army Corps of Engineers. RR-DTE-117, Attachments 8, 9 &10.

The "safety first" approach of removing the worse segments of main first achieved a rate of .6 leaks per mile systemwide in 2000 after the replacement of just under 50% of the bare steel mains. *Northern Utilities*, DR 91-081, p. 1 (1992); *Northern Utilities*, DG 99-127 / DG 00-177, pp. 2, 5 (2000). Although the Company claimed generalized corrosion throughout its entire Brockton service area and that no area was experiencing increased leak rates, Exh. BSG-Rebuttal-2, p. 7 of 14, lines 14-18, working papers the Company produced to its expert R. J. Rudden demonstrate that the towns within the service area have widely varying corrosion leak rates on bare steel. Exh. AG-14-19(c), Disk B, file 27, "DR #34 leak data from WOMS.xls," Tab

[4] The Company has put the public at risk by neglecting its infrastructure in the Brockton area, and should remedy this unfortunate misstep by immediately implementing a "safety first" approach to replacing the worse performing segments of pipe first -- on an expedited basis and at Company expense --to make up for years of lagging bare steel main replacements in Brockton during the NiSource merger rate freeze.

"Sheet 1", Column G. The data extracted from the Company's Work Order Management System ("WOMS") shows "leaks / feet" rates from as low as zero for Rehoboth to as high as .018 "leaks / feet" for Avon and the city of Brockton. *Id.* The town of Northhampton has a rate of .045 "leaks / feet" rate on bare steel. *See also* Exh. AG-14-19(c), Disk B, file 27, "DR #34 leak data from WOMS.xls," Tab "leakinfo", Columns C-E (listing corrosion leaks on bare steel by pipe diameter, town and year of installation). This substantial variance indicates that certain areas within the Company's distribution system indeed experience higher rates of corrosion, and could represent increased danger to the public, while other areas may show relatively stable rates of corrosion. The Company should target these higher risk segments first with accelerated replacement to reduce its number of corrosion leaks and safeguard people and property within its distribution territories.

By first addressing the most risky segments, the Company may find, as its subsidiary Northern Utilities did, that it need not replace its entire unprotected steel distribution system before leak rates descend to lower levels. The Company's alternative under the "geographic" approach of the SIR does not target the worse segments of pipe first and requires the costly replacement of the entire unprotected steel infrastructure on an accelerated schedule.

2. The Company Did Not Replace Sufficient Quantities Of Bare Steel Main In Brockton During The NiSource Merger Rate Freeze

Even though Bay State claims its replaces the most at risk segments of main in its distribution system, Co. I. Br., p. 26, it has not provided any clear support for the conclusion that it, in fact, replaces the worst segments first and intends to do so in the future. According to other evidence in the record, Bay State certainly did not replace the worst segments first under the SIR program, which started in 2004. RR-AG-20(c), p.2 of 24 ("The project will **not**, on a segment by segment basis, be linked to the worst segment for every project") (emphasis added). And for a number of years following the NiSource merger and before the SIR program, the Company ordered its crews to repair, rather than replace, mains. Ex. BSG-AG-2-22, Attachment (statement of Company foreman). Rather than follow a schedule of main replacements driven by corrosion mitigation principles, the Company seems to replace mains at the rate of depreciation for overall plant. RR-AG-20(c), p. 2 ("Generally replacing facilities at rate = to depreciation for overall plant"). Even the Company's own expert, R.J. Rudden, believes that Bay State's approach to unprotected steel main replacement in Brockton has been insufficient to offset its corrosion leak problems there. Exh. AG-2-16(a), p.3 ("[I]t is Rudden's opinion that BSG's efforts in replacing its aging bare and unprotected coated steel mains in the Brockton Division have not stemmed a continuing increase in Brockton's corrosion leaks.") This conclusion comes as no surprise since the Company sharply reduced its bare steel main abandonments in the Brockton area following the NiSource merger. Ex. AG-2-39, 1 of 4 (steady 68% decline between 1998 and 2003). The Rudden Reports never specifically address this issue. Leaving at-risk pipes in the ground simply encourages leaks at an ever accelerating rate. AG-2-16(b), p. 4 ("Industry studies have shown that 'when a section of pipeline system starts to develop leaks, further leaks will develop at a continuously increasing rate.'"). There can be no doubt that the Company failed to maintain its system properly when it did not remove sufficient quantities of the most at risk bare steel pipe in the Brockton service area during the NiSource merger rate freeze. Customers should not now have to pay for this poor judgment.

3. The Rudden Reports Use Understated Replacement Rates

To help convince the Department that it lacks the ability to replace its steel at an appropriate rate without extra payments from customers, the Company defines its "historic" steel replace rate as the average over the last five years and predicts it will take 30 to 40 years for full replacement. Co. I. Br., p. 27; Exh. AG-2-16(b), p. 6. This "historic" rate is unreliable and understated since it encompasses the merger rate freeze when the Company deferred bare steel main replacements and severely cut its staff. When calculating its "historic" replacement rate, Rudden should have excluded 2000 - 2002 main replacement figures and used a ten year period (1992 -- 1999, 2003 -- 2004) to correct for the Company's deferrals.[5] The Company's SIR plan is not proactive, as it claims, Co. I. Br., p. 24, but reactive to an apparent predicament of its own creation.

4. The Payments For Accelerated Replacement Under SIR Are Unnecessary Since The Company Has Proposed A PBR Mechanism

The Company argues that the SIR adjustment to rates is necessary to "stem earnings erosion that will occur during the SIR" and "to ensure that SIR expenditures by Bay State can be reviewed relatively easily by the Department." Co. I. Br., p. 24. The price cap mechanism Bay State proposed already has easily administered adjustments to provide for additional costs the Company may need to accelerate main replacement, so the additional payments under SIR are

[5] The Company uses several different calculations of its historic replacement rate that vary widely. When discussing its alleged diligence at system improvement, the Company claimed that "Bay State **removed** almost 700 miles of unprotected steel mains from its system in the last **19 years**" leaving 583 miles remaining. Exh. BSG/DGC-1, p. 17, lines 11-14 (emphasis added). These figures yield a long-term historic replacement rate of 36.8 miles per year (700 miles / 19 years) and full unprotected steel system replacement in 15.8 years (583 miles / 36.8 miles per year). The Company then argues that at the "historic" replacement over the last **"five years"**, it will take 30 to 40 years to replace the infrastructure, yielding a short-term historic replacement rate between 19.4 miles per year (583 miles / 30 years) and 14.5 miles per year (583 miles / 30 years). Finally, when determining "incremental" expenditures recoverable from customers under accelerated SIR replacement, the Company uses as its base cost period the "**four-year** average of historical unprotected steel infrastructure replacement costs (2000-2003)" RR-DTE-145 (emphasis added), low points during the years the Company deferred main replacement under the NiSource merger rate freeze. Exh. AG-2-39, 1 of 4; Exh. AG-2-38; Exh. UWUA 1-27.

unnecessary or duplicative. First, the PBR mechanism automatically increases the cast-off rates each year to a level sufficient to cover costs that can reasonably be expected from plant replacement. Exh. DTE-AG-2-1. Second, the PBR mechanism features an earnings sharing mechanism that would provide protection to the Company if a prudent replacement plan causes a severe earnings shortfall. Third, the annual PBR adjustments are simple to calculate and imposed a very light administrative burden on all parties. The annual SIR adjustment filing will likely involve tens of thousands of pages of invoices and other records, as well as inquiries into the prudence of the projects completed. RR-DTE-160 and -161 (withdrawn); Exh. BSG/SHB-1, pp. 42-43. Since rates will increase with each adjustment, the annual SIR filings will be tantamount to a mini-rate case since the Department will be required set a just and reasonable rate. G. L. c., 164, § 94. With a series of SIR increases for years, it will be difficult for the Department to set the appropriate return. Since the SIR is not reconciling, Exh. BSG/SHB-1, pp. 41-42, refunds for double collections may be cumbersome.

5. The Department Must Reject The SIR Adjustment Under Both Cost Of Service And Performance Based Ratemaking Precedent

The Company's proposal of a SIR adjustment in addition to a PBR is not consistent with the Department's precedent on incentive regulation, *Investigation By The Department On Its Own Motion Into The Theory And Implementation Of Incentive Regulation For Electric And Gas Companies,* D.P.U. 94-158 (1995) (goal of incentive regulation to decouple rates from costs); *Boston Gas Company*, D.P.U. 96-50 (1996), or traditional cost of service ratemaking. *Boston Gas Company v. Department of Telecommunications and Energy*, 436 Mass. 233, 234 (2002) (just and reasonable rates based on representative test year cost of service). *Accord* DOER I. Br., pp. 8-9; Exh. DOER-1. The Company has offered no legal basis for proposing a base rate case under G. L. c. 164, § 94, to establish cast off rates separating out the SIR program while at the same time requesting automatic increases in rates under a G. L. c. 164, § 1E, performance based rate plan. Unlike pension mechanisms approved by the Department, *NSTAR*, DTE 03-47 (2003), the Company's SIR mechanism is not a reconciling tariff, Co. I. Br., p. 32, and SIR adjustments represents a substantial portion of expected Company cost increases in the future. *Id.*, p. 30. Companies already pass along commodity costs of gas through the fuel adjustment clauses. Pension adjustment mechanisms, fuel charges, PBR increases and now SIR payments taken together represent a radical departure from the Department's established test year approach to setting just and reasonable rates. The SIR adjustment for accelerated payments is antithetical to both traditional cost of service regulation and incentive plans, and the Department should reject it.

B. THE PBR PLAN IS NOT APPROPRIATE

In addition to the analysis contained in the Attorney General's brief, AG I. Br., pp. 30-37, the Attorney General will address certain of the Company's arguments about its productivity analysis and PBR proposal.

1. The Company Continues To Represent Itself As A Very Small Gas Distribution Company But Is Actually The Second Largest Gas Distribution Company In The United States

Bay State Gas argues that the Department should consider the Company to be a small gas distribution company when comparing its performance to other companies. Co. I. Br., p. 185. Mr. Kaufmann in his productivity analysis, Mr. Moul in his cost of equity analysis, and Mr. Skirtich in the analysis of the customer information system costs all make this argument when asserting Bay State's superior performance. *Id.*, pp. 185, 198 (*citing* Exh. BSG-PRM-1, p. 19),

p. 56 (*citing* Exh. AG-3-16 (supp)). In fact, the Company underperforms when it is more appropriately compared to large companies.

The Department approved NIPSCO's acquisition of Bay State Gas Company based upon the expectations, and the Company's representations, that the combined companies would bring improved productivity, economies of scale and lower costs to provide service. *Mergers and Acquisitions*, D.P.U. 93-167, p. 4, 18 (1994); *Eastern-Essex Acquisition*, D.P.U. 98-27, p. 26 (1998); *Bay State Gas Company*, D.P.U. 98-31 (1998).[6] The Company claimed economies and efficiencies including gas purchases, gas facility usage. *Bay State Gas Company*, D.P.U. 98-31, pp. 24, 27 and 67 (1998). The Company also claimed the Company would achieve lower capital costs. *Id*., pp. 33 and 48-49, 56-57.

The Company's failure to recognize the efficiencies and lower costs expected of being a part of NiSource biases the results of Mr. Kaufmann's productivity analysis and his claims that the Company is more efficient than industry averages. Mr. Kaufmann performed his productivity analysis as though Bay State Gas were a 300,000 customer, standalone company with lower economies of scale and higher overhead costs per customer. Exh. BSG/LRK-2, p. 20. His analysis of variables failed to recognize that the Company is really a division of the second largest gas distribution company in the nation, a Standard and Poor's 500 company that has 3 million customers over which it can spread fixed costs. Mr. Kaufman fails to recognize that NiSource has a service company that allows the operating divisions of NiSource, including Bay

[6] The Department expects a reduced cost of service,, improved service reliability, and enhanced financial strength. *Mergers and Acquisitions*, D.P.U. 93-167, p. 4 (1994). It expects increasing productivity, lower costs, and lower rates for customers as a result of the added economies of merging companies. *Id*., p. 5.

State, to share accounting, finance, treasury, customer service, engineering, and human resources costs. Mr. Kaufmann's analysis also failed to recognize that Bay State has an electric affiliate in NIPSCO, one of the variables that he admitted was significant. *Id*. As a result, Mr. Kaufmann's analysis overstated the efficiency of Bay State Gas. The Department should reject his analysis, recognize that Bay State is a large company and accept that the total cost analysis shows the Company is actually less efficient than the industry. Mr. Moul's equity analysis reflects a similar small-company bias, causing a higher cost of equity recommendation than it warranted.

The "small company" claim can also be seen in the Company's analysis of its costs efficiency. In the Customer Information System ("CIS"), for example, the Company compares its cost per customer to that of other utilities that are considered small, less than 500,000 meters, rather than an analysis comparing the cost per customer to those of a size similar to NiSource. Exh. AG-3-16 (supplemental), pp. 2 and 6. Using the appropriate comparison, the Company's costs are twice what they should be when compared to those of similarly sized companies.

The Company responded to the Attorney General's recommendation the consumer dividend to be included in the productivity factor should be between 0.5 percent to 1.0 percent, consistent with first generation price cap plans, AG I. Br., pp. 34-35, *Berkshire Gas Company*, D.T.E. 01-56, pp. 10-11 and 19-21, *citing Boston Gas Company*, D.P.U. 96-50 (Phase I), pp. 262-283 and 320, with a reference to the most recently approved PBR Plan for Blackstone Gas Company in D.T.E. 04-79 as the most relevant precedent. Co. Br., p. 186. As the Department knows, Blackstone Gas truly is a small company and the settlement approved by the Department specifically stated that its terms could not be used as precedent. *Blackstone Gas Company*, D.T.E. 04-79 (2004). The appropriate precedent for Bay State is that of a first generation price cap plan of the type approved in the Berkshire Gas Company plan in D.T.E. 01-56. Using this precedent, the consumer dividend would be a full one percent. *Berkshire Gas Company*, D.T.E. 01-56, pp. 10-11 and 19-21 (2001).

2. SIR Defeats The Purpose Of The PBR

Bay State tries to support its proposed second generation consumer dividend by claiming that it has no opportunities to achieve additional productivity gains, similar to Boston Gas in D.T.E. 03-40. Co. I. Br., pp. 186-187. This position is not supported by the record. A review of the Company's Administrative and General Expenses since the merger demonstrates the opposite. In 1997, the year before the merger approval, the Company's total Administrative and General Expenses amount was $46,087,553. 1997 Annual Return to the Department, p. 47, line 42. During 2004, the test year in this case the A&G Expense amount had increase to $54,519,888. 2004 Annual Return to the Department, p. 47, line 42. This represents a compounded growth rate of 2.43 percent. [$0.0243 = [1 - (54{,}519{,}888 / 46{,}087{,}553)^{(1/7)}$].[7] During that same period from 1997 to 2004, the Gross Domestic Product Implicit Price Deflator only changed from 0.9541 to 1.0823. Exh. BSG/JLH-3, MCS Workpapers, p. 398. This represents only a 1.82 percent annual inflation rate during that period [$0.0182 = [1 - (1.0823 / 0.9541)^{(1/7)}$]. *Id.* Thus, contrary to the Company's claims, the growth in A&G expenses at rates 33 greater than the rate of inflation clearly indicate there has been little if any productivity gains from the merger.[8]

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[7] The distribution, transmission, customer accounts, and sales expenses were removed from this analysis given the Company's own admission that it has been understaffed prior to the test year.

[8] The rate of increase in the Company's A&G expense of 2.43 percent is 33 percent greater than the rate of inflation of 1.82 percent. [0.336 = [2.43 / 1.82 - 1]

The Company's responded to the Attorney General's assertion that the addition of the SIR adjustment will defeat the whole purpose of the price cap mechanism and Performance Base Ratemaking, AG I. Br., pp. 35-37, by claiming that its focus on public safety objectives complements the PBR and would not be achieved by the main PBR mechanism. Co. I. Br., pp. 187-188. This argument does not address, however, the method by which the Company identifies which capital additions are safety related. For example, the Company could define each and every retirement of a unit of property as being safety related. The Company might assert that retirement of any old and leaking pipe main or services is safety related, or that a storage tank should be replaced because it might leak. The Company could, conceivably, assert that all of its plant assets of the Company are needed for safety and reliability.

Arbitrarily removing costs from the Price Cap formula as the Company proposes here, renders the formula useless for determining price cap increases, since the productivity factor is based on indexes that are total cost, including all labor, all operations and maintenance, and all capital costs. AG I. Br., p. 37. Bay State Gas, through its witness Mr. Kaufmann, agreed that the productivity factor is based on the change in all inputs: labor, capital and materials. Tr. 4, pp. 705-708. The fact that the price indexes that were used to determine the productivity factor in this case were based on the total costs of service of distribution service means that the prices and the costs used in the formula must provide for the total cost of service. The Company cannot pull out one expense item, whether it is capital costs or pension and PBOPs costs, without destroying the purpose, incentives and the quantified relationships of the formula. *Id.* Moreover, if the Company were allowed full recovery of capital additions through a SIR mechanism on top of the price cap formula, the Company will have no incentive to minimize those costs as it would if it had just the price cap formula. With dollar for dollar annual recovery of its capital costs, the Company will make have the incentive to expand, assign, and allocate costs whether direct or indirect costs to those projects. The fundamental balance of incentives in the price cap mechanism would be lost.

The Company responded to the loss of the integrity of the price cap formula by claiming its proposed formula will prevent double recovery of steel replacement costs. Co. I. Br., pp. 188-189. This claim, however, is incorrect. The base rate in the Company's proposed price cap formula includes the test year end capital costs associated with the mains, services, meters, etc. that the Company seeks special treatment for through the SIR adjustment mechanism. Exh. BSG/JES-1, Sch. 17, p. 4. The fundamental nature and purpose of the increase in base rates associated with the price cap increase is to provide for the increase in costs associated with plant replacements. *Id.* The Company can claim that there was no double recovery only by removing all of the test year capital costs embedded in base rates associated with those plant items that the Company seeks special treatment for in the SIR adjustment. Since the Company's proposed price cap formula only removes the incremental main, service, and meter investment made after the test year from the price cap increases, the Company will recover twice for the replacement costs -- once through the price cap increase and a second time through the SIR adjustment mechanism. Thus, notwithstanding the Attorney General's argument *supra* that the removing costs from the price cap formulas will destroy the integrity of the formula, the Company will recover the capital costs associated with its mains, services, and meters twice.

IV. THE DEPARTMENT SHOULD ALSO REJECT THE $22.2 MILLION RATE INCREASE

A. RATE BASE

1. The Gain On Sale From The Westborough Headquarters Is Too Low

The Company argues that it has properly recognized the $722,997 gain on sale of the Westborough, Massachusetts headquarters because: 1) the Company used its business judgment in deciding whether to sell the Westborough property; 2) Bay State's cost/benefit analysis at the time of sale showed the Company's decision was prudent; and 3) there was a gain on the sale which flowed to ratepayers through this rate proceeding. Co. I. Br., p. 85. The Department should reject these arguments because, first, the Company had promised the Department that it would not sell the Westborough property.[9] *See Bay State Gas Company*, D.T.E. 98-31, Order p. 50; UWUA I. Br., p. 60. Second, the Company sold the headquarters at a price that was nearly $1 million below its cost ($10,524,000 versus $11,409,654) without the benefit of an appraisal or other market valuation. RR-AG-51; RR-AG-52.

The Company attempts to further reduce its net gain on the sale by adding a $276,000 "Condition Subsequent paving" expense and a $100,000 "Attorneys fees" expense, neither of which appears on the June 30, 1997 settlement statement or are explained elsewhere in the record. Co. I. Br., p. 85; RR-AG-49, Tab 2.[10] As described in the Attorney General's initial brief, the Company's attempt at a cost/benefit analysis was inadequate since it used only a one-year time frame, instead of a 25-year time frame that reflects the lease-back portion of the sale transaction. AG I. Br., p. 40. The Company cannot support the soundness of these additional expenses or its "business judgment" without a cost/benefit analysis conducted before the sale.

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[9] In D.T.E. 98-31, the Department recognized that retention of the Westborough headquarters was an important aspect of the Merger. Order, p. 50.

[10] The Company's assertion that "it is reasonable to assume that $100,000 in attorney and other professional fees (appraisals) were obtained and account for the difference" is unverified and, consequently, the Department should not rely on it. Co. I. Br., p. 85, n. 33.

AG I. Br., p. 40; *Cambridge Electric Company*, D.P.U. 89-114/90-331/91-80, Phase I, Order at 96-98. Nor can the Company assert that ratepayers received all the gain to which they are entitled because the Company has not disclosed the full purchase price, conducted a cost/benefit analysis that reflects the full lease term, or explained the nature of all sale expenses. *Boston Gas*, D.T.E. 03-40, p. 180.

The Department should recalculate the net gain based on the Company's original cost as of the date of sale, $11,409,654, reduced by the verified sale expenses ($278,726), the net book value of the building and land ($9,280,444) and the 16.4% allocation to Northern ($303,479), resulting in a net gain attributable to Bay State of $1,547,005. Exh. BSG/JES-1, Sch. JES-6, p. 7 of 20, line 10. The Company has not satisfied its burden of proof, so the Department should increase the net gain attributable to Bay State for the sale of the Westborough property by $824,008 over the gain reported by the Company. *Id*

2. The Company Under-Reported The Gains From Propane Sales

The Company applied an incorrect standard of proof in trying to justify its propane properties gains by failing to produce evidence of the gross sale amounts and failing to conduct a cost/benefit analysis. Co. I. Br., pp. 87-88; AG I. Br., p. 41, n. 22. The standard for recognition of a sale as "prudent" is whether there is a benefit to ratepayers as shown by a cost/benefit analysis, not whether the sale was put to bid or designed to meet operational needs. *Cambridge Electric*, D.P.U. 89-114/90-331/91-80, Phase I Order, pp. 96, 98; AG I. Br., pp. 41-43. Bay State failed to prepare such an analysis.

Also, the record clearly shows that Energy USA, the propane purchaser, was and is an affiliate of NiSource. Exh AG-1-98(B), p.1 of 7; AG I. Br., p. 41. Cost/benefit analyses are especially necessary when an affiliate is involved as a means to assure ratepayers and the Department that the Company spends ratepayer funds appropriately, and that cost/benefit analysis begins with disclosing the gross sale amount. The Department closely scrutinizes payments to an affiliate that are included in the rate base to prevent abuse of ratepayer funds: "In order to qualify for inclusion in rates, any payments by a utility to an affiliate must be (1) for activities that specifically benefit the regulated utility and do not duplicate services already provided by the utility, (2) made at a competitive and reasonable price, and (3) allocated to the utility by a formula that is both cost-effective and nondiscriminatory within both those services specifically rendered to the utility by the affiliate and for general services which may be allocated by the affiliate to all operating affiliates." *Fitchburg Gas and Electric Company*, D.T.E. 02-24/25, Order (2003) p. 180, *citing Hingham Water Company*, D.P.U. 88-170, at 21-22 (1989); D.P.U. 85-137, at 51-52. The Company has not provided record evidence that will permit the Department to weigh the sale of propane assets against the Department's standards.

Moreover, the Company has not complied with the Department's rules regarding sales of assets to affiliates:

> Pursuant to 220 C.M.R. § 12.04(1), a distribution company may sell, lease, or transfer to an affiliate an asset which has been included in a company's rates, provided that the affiliate is charged the higher of either the net book value or the market value of the asset. Pursuant to 220 C.M.R. § 12.04(2), a distribution company is permitted to sell, lease, or transfer to an affiliate assets (other than those included in 220 C.M.R. § 12.04(1)), provided that the price charged for the asset is equal to or greater than the distribution company's fully allocated cost to provide the asset.

Berkshire Gas Company, D.T.E. 01-56, Order (2002) p. 45. The Company has not provided the Department with sufficient information to evaluate either the net book value, the market value, the price charged or the fully allocated costs of the propane properties.

To ensure that Bay State's ratepayers receive all the gain to which they are entitled as a result of the propane properties sale, the Department should increase the net gain on sale by beginning the calculation with the gross proceeds, not the net. *Boson Gas Company*, D.T.E. 03-40 Order, p. 180; AG I. Br., p. 42. Since Bay State failed to provide the Department with evidence of the gross proceeds of this sale to an affiliate, AG I. Br., p. 41, n.22, the Department should, at a minimum, disallow the deduction for the portion of gain allocated to Northern Utilities ($38,398) as unsubstantiated.

3. The Department Should Remove The CIS Program From Rate Base

The Company, in response to the Attorney General's recommendation that the Department should remove the costs of the Company's Customer Information System ("CIS") program from rate base since the Company made no effort to control or contain those costs and it failed to put the project out to bid, AG I. Br., pp. 43-44 *citing Boston Gas Company*, D.T.E. 03-40, pp. 82-84 (2003); *Western Massachusetts Electric Company,* D.P.U. 85-270, p. 20 (1986); and *Massachusetts-American Water Company*, D.P.U. 95-118, pp. 45-46 (1996), *Boston Gas Company*, D.P.U. 93-60, pp. 27-29 (1993), claims that its total investment in the CIS was reasonable compared to similarly sized gas utilities and resulted in a lower cost per bill issued on a forward looking basis. Co. Br., p. 56. A review of this study, however, proves that its costs are well above those companies of similar size.

To support its claims of reasonable costs, the Company submitted a study conducted by the Meta Group which compared CIS implementation costs for groups of small, medium and large utilities all over the country. Exh. AG-3-16 (Supplemental). Although this study compares Bay State to small utilities, most of the CIS technology installed by Bay State was derived from and is an extension of NiSource's system, a much larger company. Tr. 15, pp. 2528-30. The costs to implement this technology would be more appropriately compared to companies in the **large** utility grouping of the Meta Group study. In that comparison, Bay State's cost per meter adjusted for inflation ($74.59) is more than double that of 5 out of 7 other companies in the study ($27, $29, $31, $33 and $37). Exh. AG-3-16 (Supplemental), pp. 6 and 8. Contrary to the Company's claims, the Company's CIS investment was neither reasonable nor resulted in a lower cost per bill issued on a forward looking basis. The Department should exclude from rate base the net plant addition costs of $11,182,919.[11]

4. Bay State Did Not Justify Its Revenue Producing Plant Additions

The Department should remove from rate base the projects for which there are excessive costs overruns, since the Company failed to demonstrate that its actions were prudent in terms of the control of cost overruns. AG I. Br., pp. 46-47 *citing Boston Gas Company*, D.P.U. 93-60, pp. 24-25 (1994); *Western Massachusetts Electric Company*, D.P.U. 85-270, pp. 22-23 (1986); *Boston Edison Company*, D.P.U. 906, p. 165 (1982). Merely identifying growth projects, submitting lists of costs and providing a summary list of those projects created solely for the rate case is not adequate justification to include the costs in rate base. Co. Br., pp. 46-47. The record evidence clearly demonstrates that the Company allowed cost overruns without sufficient efforts to contain those overruns. *See* Exh. DTE-3-22 Revised and Exh. DTE 3-27 Revised. The Department should not require ratepayers to pay for the imprudent management of these overruns, *Boston Gas Company*, D.P.U. 93-60, pp. 24-25 (1994); *Western Massachusetts*

[11] The Attorney General agrees that the Department should remove the net investment associated with the CIS system from rate base, along with the annual amortization of the costs.

Electric Company, D.P.U. 85-270, pp. 22-23 (1986); *Boston Edison Company*, D.P.U. 906, p. 165 (1982), but should disallow the expenditures for the projects identified in the Attorney General's Initial Brief. AG Br., pp. 46-48.

5. The Nondiscretionary Plant Additions Evidence Is Not Clear And Reviewable

The Department should remove from rate base the cost of non-discretionary projects for which the Company did not perform a cost-benefit analysis or show cost containment efforts. AG Br., pp. 47-48 *citing Boston Gas Company*, D.T.E. 03-40, p. 82; *Boston Gas Company*, D.P.U. 93-60, p. 27 (1993); *Western Massachusetts Electric Company*, D.P.U. 85-270, p. 20. Although the Company claims that, overall, it contained costs for non-discretionary projects, those statements, without support, do not meet the Department's standards for "clear and reviewable evidence." Co. I. Br., p. 45.

The Company's witness repeatedly stated that measures the Company may use to try to contain costs are irrelevant because non-discretionary projects, by their very nature, need to be done. Tr. 21, pp. 3394, 3401-02, 3407-08. Simply because a project is non-discretionary, however, does not mean that the Company should not use every effort to control and contain costs. Prudent management requires the review and control of project costs, whether or not a project is discretionary. The Department should exclude the cost overruns of non-discretionary projects from rate base because the Company did not provide any "clear and reviewable" evidence that it actually contained costs for those projects.

6. Construction Work In Progress Is Not A Verifiable Rate Base Addition

In response to the Attorney General's recommendation that the Department deny the

Company's request to add construction work in progress ("CWIP") to rate base since it is not plant in service at test year end, AG I. Br., pp. 48-50 *citing Massachusetts Electric Company*, D.P.U. 92-78, p. 5 (1992) and *Bay State Gas Company*, D.P.U. 92-111, p. 64 (1992), the Company claims that its incorrect accounting led to the miscategorization of these costs during the test year. Co. I. Br., pp. 59-60. The Company claims, without any record support, that it has used the same erroneous accounting methods applicable to construction work in progress for at least ten years, since its last rate case. *Id*. The Company's argument does not meet the Department's standards for inclusion of plant in service to the rate base and, therefore, the Department should not include the $1,053,621 CWIP in the rate base. Furthermore, in the absence of any evidence to support the Company's claims, the Department should not rely on any of the plant in service numbers presented in this case until an independent auditor can audit those amounts.

B. EXPENSES

1. The Company's Depreciation Study Is Invalid

The Department should not give the Company's depreciation study any evidentiary weight because the Company excluded specific data that would have allowed the Department to clearly see how the Company determined its proposed values and to evaluate the propriety of the values, service lives and salvage parameters. The Company relied on generalized, and apparently anecdotal, opinions rather than specific data. For example, the Company asserted that it combined its reliance on historical plant data with "interpretation of the Company's past experience and future expectations." Co. I. Br., p. 132. The Company stated that it used the "historical data and information from Company personnel relative to current and perspective factors affecting the retirement of plant." *Id.,* pp. 132 - 133. Mr. Robinson, the Company's depreciation witness, then used these unidentified factors and information[12] to "determine the appropriate future lives over which to recover the Company's investment in depreciation plant and net salvage values." *Id.*, p. 133. The Company's depreciation study, however, does not explain how Mr. Robinson determined the proposed life and salvage values reflected in his depreciation study. The Department should not allow these vague assertions and unidentified sources of information to constitute "sufficient justification" for a request for customers to pay tens of millions of dollars annually.

a. Account 376 - Mains - Net Salvage

The Department should reject the Company's net salvage value of -15% for Account 376 - Mains and should, instead, retain the existing -10% net salvage value. AG I. Br., p. 56. The Company's value is based on a misleading picture of historical data, Co. I. Br., pp. 138-139, and its criticism of Mr. Pous' approach is without merit. Mr. Pous' reliance on the most current 10 years of historical data rather than relying on data dating back 24 years is well-justified, AG I. Br., pp. 56-59, and that data support retaining a -10% net salvage value. As shown in Exhibit BSG/EMR-1 page 7-19 under the column "Net Salvages," 79% of the annual values between 1980 and 1993 were more negative than the Company's proposed –15%. Alternatively, only 20% of the values between 1994 and 2003 were more negative than a –15%. Thus, relying on the older data produces a trend to <u>less</u> negative values. Reviewing the historical data in the Company's depreciation study shows that four, out of the six, years referenced by the Company,

[12] The Company did not identify either the factors or the personnel supplying the information. The Company also failed to provide record evidence of any specific information the Company personnel provided.

do <u>not</u> exceed a negative 11.88% (a -10.45%, -11.48%, -11.88%).

Next, the Company claims that cost of removal "will continue to increase" based on its flawed inflation escalation analysis. Co. I. Br., p. 139. The Company did not provide any verifiable data that supports this assumption. Although there may be increases in labor or other types of costs, that alone does not constitute evidence that the overall cost of removal on a percentage basis will become more negative. If that were the case, the historical data would show a continuously <u>increasing</u> negative level of cost of removal. That is simply not the case. Instead, the historical data clearly shows that the level of negative net salvage has been <u>decreasing</u> from the 1980s and further decreasing or becoming less negative into the early 2000s. Exhibit BSG/EMR-1 page 7-19.

The Company also did not, and could not, provide any analytical analysis that would demonstrate that the additional levels of future retirement costs from the SIR program would produce a value greater than a -10%. Plotting the cost of removal, rather than net salvage, against the age of retirements to determine the relationship is an appropriate approach, but only one data point would have changed from the Attorney General's approach and that correction would <u>not change the relationship</u> presented by the Attorney General's witness (5% rather than 3% for the last data point in Exhibit AG-6 page 15). Co. I. Br., p. 140. This can clearly be demonstrated by the actual data contained on Exhibit BSG/EMR-1 at page 7-19 for calculating cost of removal percentages and the information contained in Rebuttal Exhibit EMR-R1, where the age of retirement is set forth.

The Company's claim that the cost of removal does not mean identification by age of the plant retired and that, "there is no direct linkage between the specific age and dollar amount of a retirement and the corresponding cost of removal in the Company's data" contradicts the Company's forecast of future cost of removal, as can be seen on Exhibit BSG/EMR-1 at page 7-21. Co. I. Br., p. 140. The Company applied a 2.75% escalation factor to the number of years between the estimated average service life and the calculated age of retirements. In other words, the Company relied on the age of the retirements to determine future cost of removal due to the difference between estimated average service life and age. In spite of this attempt to minimize the relationship of age to cost of removal percentage, the Company then attempts to demonstrate that age does have an impact. Co. I. Br., p. 141. The Company relies on a linear regression analysis and states that it "was able to correctly capture the relationship of the Company's cost of removal and the average age of retirements with a linear analysis."

The Company also did not explain its use of an R^2 statistic to measure the degree of explanation of the model between the independent and dependent variables in a linear regression. The R^2 statistic produced only a 4% result. Exhibit EMR-R1. This means that 96% of the relationship depicted in Mr. Robinson's graph is not explained by the age relationship he presents. The Company has not, and cannot, based on the record information, provide "sufficient justification" for its proposed net salvage value for Account 376 - Mains.

b. Account 380 - Services - Net Salvage

The Department should reject the Company's proposal and adopt the recommendation of Mr. Pous for a -110% net salvage for Distribution Account 380. Contrary to the Company's position, Co. I. Br., p. 145, the Department should order the Company to require a much more thorough and detailed justification for its proposed net salvage factors in its next depreciation study.

The Company's reliance on the most recent four 3-year rolling bands (back to 1998) to support a -170% net salvage value is misplaced. Co. I. Br., p. 142. Those bands show that negative net salvage has been above -110%. AG I. Br., p. 60; Exh. AG-6, p. 21. The four most recent 3-year rolling band analysis for Account 380 range from a low of a -130% to a high of only -159%, far short of the Company's proposed -170%. Exhibit BSG/EMR-1 at 7-26.

The Company also attempts to justify its proposal by claiming that a review of all years of historical data produces a value of -170%. Co. I. Br., pp. 142-143. The Company notes that the purpose of a depreciation study is to project future periods and not historic periods, *Id.*, pp. 132-133, but the -170% is a historic value going back to 1980. The Company has put forth inconsistent positions as it attempts to rely solely on historic data when its own forecast of the future indicates values more than double that level. Exhibit BSG/EMR-1 at 7-27.

The Company also unsuccessfully attempts to explain why its relationship of negative net salvage between Accounts 376 and 380 is dramatically out of line with the industry. Co. I. Br., p. 143. The Company asserts that because the relative level of retirement activity in relationship to original cost is greater for Services than Mains, one would expect higher levels of cost of removal for Services. *Id.* The relationship the Company proposes, however, is dramatically different than the relationship exhibited by the industry. Exhibit AG-6 page 18. The industry is also subject to the same set of facts when comparing the level of original cost and retirement activity of Services to that of Mains.

c. Account 376.4 - Plastic mains - average service life

Although the Company claims that Mr. Pous' graphical presentations of better fitting curves "was plotted in a manner that made the variance … appear far larger than they really are," the Company does not dispute that his proposals are better fits. Co. I. Br., p. 145. The Company's claim that it did not ignore the data beyond 25 years of age is inconsistent with its presentation at BSG/EMR-1 at page 5-29, which shows that the Company's proposed life-curve combination clearly departs from the actual observed retirements beginning at approximate age 25 years.

The Company's assertion that it relied on some "additional analysis" that was not part of Mr. Robinson's filed depreciation study as support for its proposed 55-S2 life-curve combination also fails to meet its burden of proof. Co. I. Br., p. 146. The new "additional analysis" produced a 41-S2 life-curve combination. *Id.* The Company failed to provide sufficient justification for this analysis. Instead, it arbitrarily selected a value from a limited range of select industry data without demonstrating the propriety of those results or its selection. Co. I. Br., p. 146. Moreover, the Company failed to explain why its existing average service life was already above the industry average.

d. Acct. 376.2 Coated/wrapped steel mains - average service life

The Company attempts to bolster its proposal by claiming that future retirements in this sub account "cannot be greater than 50 years." Co., I. Br., p. 147. This assertion, without any evidentiary basis, does not constitute credible evidence, and, indeed, Mr. Robinson did not use this restriction when he developed his proposed life for this sub-account.

The Department should not consider the Company's introduction of a limited industry comparison. Co. I. Br., p. 148. As noted in Mr. Pous' testimony, the Company provided "industry statistics as they relate to the property accounts within the depreciation study for which reference was made to industry data". Exhibit AG-6 page 33. Neither this, nor any other, Mains sub-account was reflected in the industry data provided. Moreover, the Company chose not to provide the industry data for those utilities that "experienced service lives" longer than its proposal. This selective use of industry information in the Company's Initial Brief does not constitute "sufficient support" for its proposal.

e. Other general depreciation issues

The Company raises additional general issues in its initial brief that do not provide any support for its proposal. First, the Company states that, "if depreciation rates are too low, capital costs will be under recovered prior to the retirement of plant. In that situation, future customers will subsidize current customers." Co. I. Br., p. 130. The converse is also true, however; if depreciation rates are set too high, current customers will subsidize future customers and that capital will be over recovered prior to the retirement of investment. Second, the Company claims that Mr. Pous, the Attorney General's witness, did not perform a complete depreciation study and the Department should, therefore, not rely on his assertions. Co. I. Br., p. 136. Mr. Pous, however, submitted testimony relating to 87% of the dollars of plant investment, and whether Mr. Pous reviewed other accounts does not change the fact that the Company bears the burden of proof for distribution accounts 376 Mains and 380 Services.

For these reasons, the Department should reject the Company's proposed depreciation rates for these accounts.

2. The Westborough Lease Expense Is Too High

The Company contends that its Westborough lease expense for the test year, $992,551 ($1,172,165 gross lease expense less sublease revenues of $179,654) (Exh. AG-1-29) should be included in the cost of service because: 1) it is a normal on-going expense, 2) the terms reflect market value when executed; 3) the Company is contractually obligated to pay it; 4) the building is reasonable in size and location; 5) it is partially offset by rental revenues to its sublessees; and 5) UWUA's downward adjustment is irrational. Co. I. Br., pp. 85 (note 34), 119. This argument lacks merit on several grounds.

First, the Company failed to produce the basic lease information, a cost/benefit analysis, market valuations or a market appraisal that should have been done for the property prior to selling the Westborough headquarters. Exh. AG-3-42(3), (6); RR-AG-52; Tr. 9, pp. 1570-1573. This failure precludes the Company from validly contending that the lease expense overall is reasonable, that it was based on market prices at the time of sale, or that leasing the property would be less expensive than retaining title ownership, the Department's standard of review. D.P.U. 89-114/90-331/91-80, Phase 1, pp. 96, 98; AG I. Br., p. 40.

Second, a contractual obligation to pay is not relevant to the question of whether the lease expenses are reasonable. Reasonableness refers to whether the ratepayer receives benefit, not whether the Company has to pay the expense. Third, the Westborough facility is now simply too big for the remaining 26 Bay State employees. The 89,145 square foot building housed only 22 Bay State employees in 2004 and 26 in 2005, but 138 in 2000. RR-AG-2; Exh. AG-3-28, p. 5; Exh. AG-3-41; Exh. UWUA-3-32. This equates to a 2004 per capita lease expense of $53,280 ($1,172,165/ 22). Exh. AG-3-42(3). In contrast, UWUA calculated a much lower per capita lease expense of $10,510 for Bay State in 2000, less than one-fifth of the 2004 expense. UWUA I. Br., p. 61.

The NiSource Service Company has clearly recognized that the size of the Westborough facility exceeds Bay State's diminishing employee numbers and has begun subleasing portions of the premises in an attempt to minimize its lease obligations. During the test year, the Company sublet 16,216 square feet, representing 18.2% of the total square footage, to an unidentified sublessee. Exh. AG-3-28, Attachment p. 5. The sublease revenues did not completely ameliorate the financial burden of the lease payments or prove that leasing Westborough is cheaper than if the Company had not sold the property. Cambridge Electric Company, D.P.U. 89-114/90-331/91-80, Phase I, Order at 96-98. Furthermore, Bay State ratepayers received no benefit from the sublease payments because those revenues were allocated entirely to Northern Utilities. Exh. AG-3-28, Attachment p. 5.

Finally, even though the Company challenges UWUA's revised lease expense calculation as irrational, Co. I. Br., p. 119, the UWUA proposal that the Company recover 10.95% above its 2000 per-employee lease expense, which is $641,355, UWUA I. Br. at 61-62, does have merit. The beginning point of the lease expense adjustment, however, should include a reduction for the sublet portion.

Department precedent requires that lease expenses be prorated and reduced to eliminate expenses associated with property not used for utility purposes. *Boston Gas*, D.T.E. 03-40, p. 173. Consequently, the Department should remove 18.2% of the gross lease expense ($1,172,165 x 18.2% = $213,334) from the cost of service to reflect space rented to the outside tenant. Furthermore, the Department should use the lease expense of $1,172,165, not the annual costs (which include O&M, lease, property tax and utilities) of $1,609,105, and the correct number of Bay State employees (22) instead of 55 employees (which includes NCSC and Bay State). The corrected lease expense is $256,542 ($11,661 inflated per-capita employee expense x 22), which is a reduction of $736,009 from the Company's proposal ($992,551 - $256,542).[13] UWUA I. Br., p. 62.

3. The Department Should Reduce Sales Promotional Expenses

The Company has only provided an aggregate, after-the-fact comparison of the revenues received and the sales promotional expenses. Co. I. Br., p. 121. That approach, however, does not measure whether individual programs are cost-effective prior to implementation, and does not compare the cost of adding the customer to the system to the cost of the programs, as the Department requires. *Boston Gas Company*, D.T.E. 03-40, Order pp. 247, 249; AG I. Br., pp. 75-77. The Company also has failed to differentiate and exclude the sales promotional expenses associated with electric conversions (AG I. Br., p. 77), which account for 844/3317 or 25.44% of the total new customers added during the test year. Exh. AG-6-14. The Company failed to comply with the Department's explicit rules set forth in *Boston Gas Company* for recovery of sales promotional expenses, and the Department should exclude $1,191,844 from the test year cost of service for sales promotional expenses.

4. The Company Has Not Justified Its Corporate Jet Expenses

In response to the Attorney General's recommendation that the Department remove the costs associated with the Company's Raytheon Hawker 800 XP corporate jet from the cost of service since the Company did not show that they were reasonable in amount and necessary to provide gas distribution service to Bay State Gas customers, AG I. Br., p. 82, the Company simply asserts that only by using the corporate jet can NiSource officers and employees

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[13] The Department should note that the Company's sublease revenues, $179,654 (Exh. AG-1-29) are less than the subtenant's allocated portion of leasing expense ($213,334). This suggests that the Company is not recovering the full pro-rata portion of its leasing expense from its subtenant based on square footage.

"continue working while conducting business" or "reach their destinations [any] more rapidly" Co. I. Br., p. 122. The record, however, does not reflect any cost-containment efforts to minimize the corporate jet expense, such as setting an expense benchmark using the costs of taking commercial flights. *Fitchburg,* D.T.E. 02-24/25, Order p. 192 (2002). The Company does not provide any evidence to show that any of the 190 flights cited in its brief were taken for purposes that benefit Bay State specifically or that the flights were for business purposes. *Id.* Indeed, none of the 190 flights listed in the Company's brief and only two of the flights listed in RR-AG-45 involved travel to or from Massachusetts. Bay State ratepayers, therefore, paid $75,222.30 [$150,444.61 / 2] per flight. Co. I. Br., p. 122; RR-AG-45 Attachment. The Department should not allow the Company to include in the cost of service any of the $150,444.61 jet expenses because the expenses do not demonstrably benefit Massachusetts ratepayers. AG I. Br., p. 82. *Berkshire Gas Company*, D.T.E. 01-56, Order p. 65 (2002).

5. Bay State Exaggerated Its Average Self-Insurance Expenses

The Company contends that its use of a normalized average for 2000 - 2004 for self-insured expenses is appropriate. Co. I. Br., p. 83. This method increases the test year cost of service for all self-insurance claims by $80,021 and is based on a five-year average of $424,075 for General Liability insurance expenses. Exh. BSG/JES-1, p. 20; Exh. BSG/JES-1, Sch. JES-6, pp. 1 (line 6) and 6 of 20; Ex. BSG/JES-1, WP JES-6, pp. 19-21 of 31; Co. I. Br., p. 83.[14] The test year expense for self-insured claims was $204,375. Exh. BSG/JES-1, WP JES-6, p. 19 of 31.

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[14] Bay State's self-insurance claim history for General Liability was $649,376 (2000), $83,263 (2001), $136,525 (2002), $1,046,837 (2003), and $204,375 (2004) for a total of $2,120,376 and a five-year average of $424,075. Exh. BSG/JES-1, WP JES-6, p. 19 of 31.

The Company cites no precedent for using a 5-year annualization instead of the test year amount. Additionally, the Company's inclusion of a $1,000,000 insurance payment in 2003 for the 1998 Attleboro house explosion skews the 5-year average well beyond the test year amount and a four-year average that excludes the $1,000,000 payment.[15] Thus, the Company's approach does not accurately reflect a representative amount or a reasonable expectation for the self-insurance expenses during the rate period.[16] Exh. AG-2; Exh. UWUA-1-11(c); *Boston Gas Company*, D.T.E. 03-40 Order (2003), p. 184; *Fitchburg Gas and Electric Light Company*, D.T.E. 02-24/25 Order (2002), p. 161. The Department should reject this approach and, instead, use the test year self insured expense amount for General Liability of $204,375, resulting in an overall test year adjustment of $5,723 for all self-insurance expenses and a reduction of $74,298 from the Company's proposal.[17]

The Company, in seeking permission to include expenses from all five years (2000 - 2004) rather than the test year, is essentially asking the Department to assume that the Company will incur a liability on the magnitude of the 1998 Attleboro explosion as a regular occurrence. Exh. AG-2. The Attleboro incident should be the exception, not the rule. The Company's

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[15] The calculation is: $2,120,376 - $1,046,837 = $1,073,539 / 4 = $268,385. Exh. BSG/JES-1, WP JES-6, p. 19 of 31. The 2003 expense ($1,046,837) is 375% times the four-year average of 2000, 2001, 2002, and 2004 ($268,385).

[16] The 1998 Attleboro explosion, which was a result of Bay State and subcontractor negligence, resulted in at least 11 liability lawsuits which were settled for over $16,000,000. Exh AG-2; Exh. UWUA-1-11. Bay State paid its deductible, $1,000,000, Bay State's insurers paid an additional $4,350,000, and the locating service paid the rest. *Id.*

[17] The calculation is: $204,375 +$72,701 (per book - Exh. BSG/JES-6, p. 6 of 20, line 1) = $277,076. $277,076 - $258,394 (workers comp) - $12,959 (auto liability) (*Id.* line 3) = $5,723. $80,021 - $5,723 = $74,298.

approach contradicts the Company's own claims loss run history for 2001 - 2005[18] and contravenes public policy by acting as a disincentive to contain liability insurance expenses.

Furthermore, the Company is seeking recovery of self-insurance expenses based on an unnecessarily high deductible level -- $1,000,000 for property damage insurance -- even though the record is devoid of any credible evidence or reason for this high deductible amount. Exh. AG-1-63.[19] If the deductible limits had been lower and reflected more accurately the Company's claim loss history and test year expense, Bay State could have shifted more of the financial responsibility for the Attleboro explosion to the insurers and away from ratepayers.[20] Clearly, the Company's business decision in setting deductible limits does not treat ratepayers fairly. For these reasons, the Department should use the test year expense for General Liability expenses and an overall test year adjustment of $5,723 for all self-insurance expenses and should order the Company to lower its deductible limit for property damages to $200,000 to approximate the test year average ($204,375).

6. The Department Should Deny The Proposed Postage Increase

The Company's request to increase the cost of service for a potential postage increase is

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[18] *See, e.g.,* General Liability Claim # AMK8965 ($44,159.31 claim for 1/26/2003 damage to house pipes), Exh. DTE 6-19 Attachment, pp. 10 and 23; GL Claim #ANN7835 ($34,493.87 claim for 12/15/2002 damages from house explosion), Exh. DTE 6-19 Attachment, pp. 10 and 23; and GL Claim #AFP5238 ($260,000 claim for 4/13/2004 damages from fire and house explosion), Exh. DTE 6-19 Attachment, pp. 12 and 25, Exh. AG-3-10.

[19] The 1998 Attleboro explosion should not be used to justify high deductibles because ratepayers, not the insurance companies, pay the deductibles. The Company should view Attleboro as an exceptional event, not as the cost of doing business. Lower deductibles will provide further incentive for the Company to minimize its exposure while providing rate payers with a fairer rate.

[20] The Company's annualized Excess General Liability premium expense was $659,428 while its 2004 test year expense was $528,957. Exh. BSG/JES-1, Sch. JES-6, page 5 of 20 (Revised Aug. 30, 2005), line 2.

inappropriate and should be denied. Co. I. Br., p. 106. The Department's precedent regarding pro forma adjustments to the cost of service is well-established. *Fitchburg Gas & Electric Light Company*, D.T.E. 02-24/25, p. 76, 195 (2002), *citing Eastern Edison Company*, D.P.U. 1580, pp. 13-17 (1984). In determining the propriety of rates for the companies under its jurisdiction, the Department has consistently based allowed rates on test year data, adjusted for known and measurable changes. *Id*. The United States Postal Service has not confirmed a postal rate increase, so the increase is not known and measurable. Exh. UWUA-3-20; Tr. 3, pp. 525-526. Such possible increases are excluded from the cost of service, *Boston Gas Company*, D.T.E. 03-40, p. 132, and the Department should remove the proposed postage increase, $67,947, from the cost of service.

7. Legal Bills Must Be Detailed To Be Recoverable

The Department should remove the Company's legal retainer fees of $62,000 related to NiSource's general counsel from the cost of service since the legal fees are (1) derived from a firm whose partner is also an employee of the Company; (2) the result of "services" that were not put out to bid; and (3) derived from invoices that are devoid of any detail that would indicate the nature of or the amount of work performed. AG I. Br., pp. 66-68 *citing Cambridge Electric Light Company*, D.P.U. 92-250, pp. 123-130 (1993) (denying recovery of legal fees where the partner of the firm rendering legal counsel is also an employee of the company); *Boston Gas Company*, D.T.E. 03-40, pp. 148 and 153 (2003) (requiring competitive bidding process); *Fitchburg Gas and Electric Light Company*, D.T.E. 02-24/25, 193-194 (2002) (requiring invoices for outside legal fees to contain the number of hours billed, the billing rate, and the specific nature of service performed). The Company's only response is that it has a long-standing relationship with the law firm and that firm is a leading business and transactional counsel. Co. I. Br., pp. 119-120.

The Company's justification -- a long-standing relationship between NiSource and its general counsel, Peter Fazio (Co. I. Br., pp. 119-120) -- is insufficient to justify charging Bay State Gas ratepayers $62,000 for undocumented, unspecified, and undetailed legal services. The blank law firm billings from Mr. Fazio's firm, Schiff, Hardin & Waite, that the Company submitted for Department review do not specify the number of hours spent on Bay State-related work, the hourly rates, dates of service, the services provided, or any of the other data the Department requires from outside counsel. *See, e.g.*, billings from Nixon Peabody LLP, Exh. DTE-15-58 (b) (Supp. 4), p. 1 of 14. These billings from Schiff do not meet the Department's standard for cost of service expenses. AG. I. Br., pp. 66-68. Furthermore, the Company identified Mr. Fazio as an outside counsel but should have acknowledged that Mr. Fazio serves Bay State in a dual capacity -- as one of the Schiff law firm's managing partners and as a NCSC officer and employee.

The Department should follow its precedent requiring the Company to file detailed invoices for legal expenses and remove the Schiff fees of $62,000 from the cost of service. *Cambridge Electric Light Company*, D.P.U. 92-250, pp. 123-130 (1993); *Boston Gas Company*, D.T.E. 03-40, pp. 148 and 153 (2003); *Fitchburg Gas and Electric Light Company*, D.T.E. 02-24/25, 193-194 (2002).

8. Advertising Expenses Are Not Supported

The Company claims that it spent $184,801 for advertising expenses to acquire customers for the Company's energy products and services ("EP&S") and, consequently, all advertising expenses should remain in the cost of service. Co. I. Br., p. 121. The record evidence, however, does not support this claim. In addition to the Westwood Sponsorship expenses and the "Mea Culpa" letter[21] expenses (RR-AG-32, pp. 15, 17; AG I. Br., p. 76, n. 45), the Company has not explained the purpose of the blank Muzak invoices (RR-AG-32, pp. 2, 3, 6, 11,13, 14, 16, 20, 21) in sufficient detail to permit the Department to determine whether they are known and ascertainable expenses that justify inclusion as rate expenses.[22] *Boston Gas Company*, D.T.E. 03-40 Order, p. 287. As the Massachusetts Oil Heat Council ("MOC") correctly notes, "the Company has failed to fulfill the Department's prescribed procedure for seeking and justifying advertising expenses." MOC I. Br., p. 11. These expenses ($12,143) should be removed from the cost of service.

The Department should reduce the remaining advertising expenses by a pro-rated portion of expenses attributable to electric-to-natural gas conversions. Since over one-fourth (25.44%) of the Company's new customers added in 2004 converted from one regulated source (electricity) to another (natural gas), the Company should have removed that percentage of the advertising expenses from the cost of service. *See supra*, Sec. IV(B)(3); *Boston Gas Company*, D.T.E. 03-40 Order, pp. 247, 249; AG I. Br., p. 76. The invoices for brochures, letterhead, envelopes, postage, notepads, letters, and coupons do not differentiate between electric conversion customers and heating oil customers. RR-AG-32. Rather, the brochures and advertising materials were designed and sent to an undifferentiated group of prospects which led

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[21] The Company has not explained the contents or purpose of a "mea culpa" letter.

[22] The Muzak invoice located on page 13 of 21, RR-AG-32, for $150.40 is a duplicate billing for services invoiced on page 6 of 21 and page 3 of 21. Also, the invoice on page 21 of 21, RR-AG-32, is in part duplicated on page 3 of 21.

to 3,317 new customers, 844 of whom were electric customers who converted to natural gas. The Department should remove at least 25.44% of the remaining ad expenses from the cost of service [($184,801-$12,143) x 25.44% = $43,924], for a total reduction in the cost of service of $56,067.

9. Bay State Failed To Remove Non-Utility Property Taxes

The Company asserts that its $310,710 adjustment to the cost of service for annualized property taxes is appropriate. Co. I. Br., p. 125. The Company, however, failed to revise its schedules to reflect the June 22, 2005 correction in which it "overlooked" the allocation of $22,538 of property expense to non-utility operations. *Id.;* Exh. DTE-1-5; Exh. AG-11-9. The Company admits that its annualized property tax adjustment should be reduced to $288,171 (Exh. DTE-1-5), so the Department should reduce the Company's request for an adjustment of the property tax expense by $22,538.[23]

10. Metscan Lease Payments Should Not Be Amortized

In response to the Attorney General's recommendation that the Department deny Bay State's request for recovery of Metscan costs covered by the five-year amortization since Metscan is not providing service to customers and has been replaced by another system for

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[23] The Attorney General reserves his right to comment on the appropriateness of the inclusion or calculation of any late-filed property tax bills. The Company has not yet produced copies of any tax bills for the record except the Brockton and Sharon non-utility property tax bills. Exh. AG-11-9. This is especially troubling since the Westborough property tax expense for 2004-05 ($136,939) may relate to non-utility activities by the unidentified Westborough subtenant who has sublet 16,216 square feet of the 89,145 square foot (18.2%) facility. Exh. BSG/JES-1, Sch. JES-9, p. 3 of 4; Exh. AG-3-28 Attachment, p.5. If the Company has not produced the Westborough tax bill and remove the correct non-utility portion when it files its revised cost of service schedules, then the Department should reduce the property tax adjustment by an additional $24,923 ($136,939 x .182) for a total reduction of $47,461 below the Company's proposed test year cost of service. The amended adjustment for property tax expense would be $263,249 ($310,710 - $47,461).

which the customers are being charged, AG I. Br., pp. 87-91 *citing Fitchburg Gas and Electric Company*, D.T.E. 98-51, p. 9 (1998) and *Boston Gas Company*, D.T.E. 03-40, pp. 90-91 (2003), Bay State Gas replies that: (1) no party contested the Metscan lease payment; (2) the Metscan rate base deserves special treatment because it was retired early; and (3) the lease payments are "investments" that should be treated like early retired plant. Co. I. Br., pp. 113-117.

The Company's claim that no party contested the Metscan lease payment is incorrect. In his initial brief, the Attorney General asked the Department to remove the Company's lease payments for Metscan from the cost of service since those assets are no longer providing service to customers. AG I. Br., pp. 87-91. This of course holds true for the existing payments that the Company has to make, as well as those that are included in the costs associated with the "regulatory asset" that the Company is proposing to create with the net present value of the future payments on those leases until they terminate. *Id.* In either case, Metscan is not providing service and has been replaced by another system whose cost is being charged to customers. Metscan is no longer used and useful so the Department should deny the recovery of these costs.[24]

The Company also claims that the Metscan rate base deserves special treatment because it was retired early. Co. Br., pp. 114-115, *citing Wyle Wood Water Works, Inc.*, D.P.U. 86-93 (1987); *Western Massachusetts Electric Company*, D.P.U. 85-270 (1986); *Fitchburg Gas and Electric Light Company*, D.P.U. 19084 (1977); *Fitchburg Gas and Electric Light Company* v. Department of Public Utilities, 371 Mass. 881, 886-87 (1977); *Fitchburg Gas and Electric Light*

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[24] "For costs a company seeks to recover in rates, the expenditures must be prudently incurred, and the resulting plant must be used and useful in providing service to ratepayers." *Boston Edison Company*, D.T.E. 98-119, p. 62 (1999); *Fitchburg Gas and Electric Light Company*, D.T.E. 98-51, at 12 (1998); *Boston Gas Company*, D.P.U. 93-60, at 24 (1993).

Company, D.P.U. 18296/18297 (1975); *Fitchburg Gas and Electric Light Company*, D.P.U. 18031-A (1975); *Fitchburg Gas and Electric Light Company*, D.P.U. 18031 (1974). In each of the case cited by the Company, however, the Department allowed special treatment of ***location specific property*** like a power plant which has a specific expected retirement date. None of the cited cases addressed mass property like the Metscan meter reading devices which have multiple retirement dates -- some before and some after the average service life. The precedent the Company attempts to rely on, then, is not applicable.

Bay State also argues that, because of this lease, the Company is now faced with an expense so extraordinary in nature and amount that the Department should allow the amortization of the nonrecurring expense to be recovered through rates. Co. I. Br. pp. 115-116. The Company, however, created the nature and amount of the Metscan lease when it decided to sell and lease back the equipment.[25] Bay State further asserts that this expense should be amortized and recovered from its ratepayers "in order to insulate the utility from business risk resulting from large, unanticipated expenditures." Co. I. Br., p. 116. The intentional execution of a lease for substandard equipment is not, however, considered an "unanticipated expenditure," and the ratepayers should not be required to share the risk of a bad investment with the shareholders. The Department should remove the amortization of the $13,216,748 from the Company's cost of service.[26]

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[25] In 1998, after the Company became aware that the Metscan devices were not operating as expected, Bay State sold and leased back the equipment for a period of time greater than the expected life of the equipment. Exh. DTE-1-20; Tr. 6, at 985-86. The majority of the amortization expense, over $10 million, is directly related to the sale and leaseback agreement.

[26] The UWUA similarly argues that the Company's implementation of the Metscan system was imprudent:

"As Mr. Brockway noted, "the Company made a bet on the future of the [Metscan]

11. The Company Should Not Recover Its CGA Bad Debt Expenses Dollar For Dollar

The Department should not allow the Company to continue to collect dollar for dollar all CGA bad debt costs. *See* AG I. Br., p.72. The Company's only argument supporting continuing its current practice rests with its claim that the same gas price volatility exists today as when the Department previously allowed gas companies to recover all CGA related bad debt costs through the CGA. Co. I. Br., p. 100. Gas price volatility is not new; it has continued for more than a decade.[27] During that time, the Department implemented its current CGA bad debt recovery policy, requiring gas companies to collect through the CGA only the portion of gas cost related to bad debt costs that are an allocation of the total bad debt allowance approved in the most recent rate case. *Fitchburg Gas & Electric Light Company*, D.T.E. 02-24/25, p. 172 (2002) and *Boston Gas Company*, D.T.E. 03-40, p. 267 (2003).

While the Company failed to provide any evidence to support a change in Department policy, KeySpan's response to a data request shows that during the time that the Department allowed Boston Gas to recover dollar for dollar its CGA related bad debt costs, it over-recovered its bad debt costs for five of the seven years it operated under the Department's DTE 96-50 directive. Exh. DTE-KED-1-1. The evidence shows that a Department policy reversal could produce undesirable results that would require consumers to pay more for gas than is just and

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> technology, a bet that has not proved profitable." Had Bay State been 'more conservative and prudent,' it would not, as a relatively small utility, have taken the lead in experimenting with this unproven technology, deployed the devices so widely throughout its system, and entered into a long-term lease arrangement. Exh. UWUA-4, p. 56. Bay State needlessly put customers at too great a risk, and therefore acted imprudently."

UWUA I. Br., p. 66.

[27] http://tonto.eia.doe.gov/dnav/ng/hist/n3050ma3a.htm

reasonable at a time when the burden is greatest. The Department should deny the Company's request and adhere to its precedent.

12. The IBM Contract Savings Belong To Ratepayers

Not only will Bay State's proposed outsourcing of the Springfield call center reduce customer service but it will unjustly reward the Company's shareholders. The Department should reject the double charge that would result from the IBM proposal. Bay State asks the Department to approve the higher employee levels that the Company established during the test year along with all of the expected increases in compensation associated with them (Exh. BSG/JES-6, p. 2) while at the same time, planning to keep economic benefits of the IBM contract when it terminates hundreds of NiSource employees and outsources these utility functions outside the U.S. Co. I. Br., pp. 10-12.

Since NiSource acquired the Company, the record evidence reveals a lack of effective and prudent maintenance policies, uneven spending in the area of operations and maintenance cuts in experienced personnel, and consequent deterioration in the quality of service:[28]

- Employee levels have dropped well below that required by law and required to provide safe and reliable service; AG I. Br. pp. 121-123; USWA Br., pp. 9-13.

- The Company has failed to maintain and replace its mains and services in a prudent manner; AG I. Br. pp. 16-22.

- The Company's cost estimating process and cost control for capital additions is at best mismanaged; *Id*., pp. 43-47.

- The Company has disconnected it telephone trunk lines to improve call response rates, sales representatives performance, removal of customer payment centers; AG I. Br. pp. 6-

[28] The Department requires utilities to maintain a high quality of service at just and reasonable rates. *Attorney General v. Department of Telecommunications and Energy*, 438 Mass 256, 264 n. 13 (2002); *Berkshire Gas Company*, D.P.U. 96-67, p. 6 (1996); *Boston Gas Company*, D.P.U. 96-50 (Phase I), p. 242 (1996); *Incentive Regulation*, D.P.U. 94-158, p. 52 (1995).

7, n. 9; USWA Br. p. 9-23.

- The Company has taken messages rather than providing service to customers when called; *Id.*

- The Company has drastically reduced sales representatives; *Id.*

- The Company has eliminated pay offices. *Id.*

Clearly, NiSource's management in Indiana has not been appropriately responsive to the needs of Bay State Gas Company's customers in Massachusetts since the merger.[29] Exh. UWUA 3-42, Tr. 501, Exh. UWUA 1-2(D), pp.1, 3, 9, 12 & Tr. 211-214. Furthermore, the types of severe reductions in employee numbers contemplated by the IBM contract could seriously hurt the quality of service to customers, given the elimination of positions and employees in Massachusetts and the move outside the U.S. of critical customer service functions. Yet, in spite of these eliminations, the Company wants the Department to include the costs of these employees for next five years.

The Company, at test year end, increased employee levels in an effort to show the Department that it will take quality of service seriously. Exh. AG-1-44. The Company proposes to annualize the costs of these employees added throughout the test year and include them in the cost of service in this case. Exh. BSG/JES-1, Sch. 6, p. 2. These employees, along with many others at the service company, however, will disappear as the IBM contract is implemented, dramatically reducing the cost to the Company from test year levels. Exh. DTE-18-1 (a), p. 4. If the Department allows the Company to implement IBM contract, then the Department should

[29] The Department should order a management audit and audit of service quality to ensure the Company attains and maintains high service quality. AG I. Br. pp. 123-125.

reduce rates to reflect the $3.43 million in annual savings associated with the contract. AG I. Br., pp. 91-94.

Although the Company argues that the Company's savings estimates are "speculative," (Co. I. Br. pp. 11-12), the fact remains that the proposal is in effect and employees have been notified that their jobs are now at risk. There are year to year savings estimates by cost area, and claims of hundreds of millions of dollars of savings to the investment community by both the NiSource and IBM in filings before the Securities and Exchange Commission. These savings are not "speculative." Exh. DTE-18-1; Exh. AG-RR-9; Exh. AG-RR-10.

The Company also argues that the savings from the IBM contract should not be included because they are only achieved over the life of the contract, not in the first year. Co. I. Br., pp. 11-12. This argument should be rejected for two reasons. First, the costs to achieve the savings should be amortized over the life of the contract, like any other interperiod cost allocation. AG I. Br. p. 93. Second, since the PBR Plan will last somewhere between five and ten years, the rates that come from this case will encompass the majority of the term and the savings associated with the IBM contract. Co. I. Br., pp. 11-12. The costs to achieve in the early years will quickly disappear under either a five or a ten year PBR Plan, and, therefore, the annual average savings must be reflected in cast off rates now.

Clearly, the evidence regarding the cost reductions from the IBM contract is sufficiently known and measurable for the Department to recognize that the Company will receive a windfall unless an adjustment is made in the cost of service in this case. The Department should reflect the expected savings from the IBM contract and reduce the cost of service by $3.43 million. AG I. Br., pp. 91-94.

C. COST OF CAPITAL

1. Short-Term Debt

In response to the Attorney General's recommendation that the Department include $153,211,854 of short-term debt in the capital structure used to determine the Company's overall rate of return on rate base since Bay State uses this money to finance its rate base as well as its operations, AG Br., pp. 95-97,[30] the Company replies:

- that its debt ratio is appropriate excluding short-term debt;
- its short-term debt is not used to finance it utility business;
- including short-term debt in capital structure will double recover the carrying costs on gas costs, and;
- Department precedent regarding the inclusion of short-term debt does not apply in its situation since that precedent only applies to small utilities.

Co. Br., pp. 191-194. The Department should reject these arguments.

First, contrary to the Company's argument on brief, Mr. Newhard showed that the Company's debt ratio, including short-term debt, is well within the bounds of the average distribution company for Standard & Poor's "A" and "BBB" rated companies. Eh. BSG-AG-1-16, Att. 2.[31] The Company's position that NiSource does not control essentially all of the Company's outstanding capital belies the evidence in the record. NiSource currently controls more than 90 percent of the outstanding securities and that percentage is increasing. Exh. BSG-PRM-5, (compare the $745 million in outstanding capital at the end of the test year with the $58.5 million in debt held by outside institutions). The existing long-term debt that the

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[30] The balance was based on the thirteen month average of short-term debt balances during the test year less the amount of cash working capital the Company requested for gas costs. *Id*.

[31] The Company argues that the information in the Standard & Poors report Mr. Newhard used is outdated, since it is more than a year old. Co. Br., p. 191. Since the report is the latest one regarding S&P's ratings, one can fairly assume that its ratings criteria have not changed, or changed enough for it has not caused it to issue another report.

Company has on its books is simply the debt remaining from pre-merger days. *Id*. Bay State does not issue any securities notes, bonds or stock to the market any longer. *See e.g. Bay State Gas Company*, D.T.E. 04-80 (2004); *Bay State Gas Company*, D.T.E. 03-65 (2003); *Bay State Gas Company*, D.T.E. 02-73 (2002).

Second, the Company claims that short-term debt is not used to finance rate base, but it makes this statement without any record evidence to support it. Co. Br. p. 192. Without any evidence to the contrary, the Department must assume that the monies from the different outstanding securities are used for all possible business purposes. *Town of Hingham v. Department of Telecommunications and Energy*, 433 Mass. 198, 213-214 (2001) *citing Metropolitan District Commission v. Public Utilities*, 352 Mass. 18, 24 (1967). The fact that the Company's capital structure with short-term debt does not equal the total rate base is irrelevant. The Company has available and is using all sources of capital to fund its businesses including its utility business. *See* 2004 Annual Return to the Department, p. 8, (2004 year-end balance of cash was $879,592, not $153 million). The cash from the short-term loans is fungible, indistinguishable from the cash derived from long-term bonds and equity. The Department should include short-term debt in the capital structure since it continues to be a source of funds for the operations of the utility business.

Third, the Company claims that it will double recover its carrying costs on gas expense if short-term debt is included in the capital structure. Co. I. Br. p. 193. This claim is simply incorrect. The amount of short-term debt that the Department should include in the capital structure would remove the short-term debt associated with the working capital requirement for gas costs as requested by the Company in this case. AG I. Br. p. 97. Mr. Newhard recommended this adjustment in his response to a record request by the Department. Exh. RR-DTE-118.

Fourth, the Company argues that the Department's precedent regarding the inclusion of short-term debt in the capital structure does not apply to Bay State because those cases addressed small utilities. Co. I. Br., pp. 193-194. Although the utilities may have been small compared to Bay State, the Company does not explain the relevance of the size of the utility. *Id.* Bay State, like those companies, depends on short-term debt in a very significant way to fund its operations. *Id.* The Department recognized in those cases that short-term debt should be included as a part of the capital structure used to determine a company's overall weighted cost of capital.[32] The record evidence indicates that the Company's interest expense was increased by more than $3 million during the test year as a result of having this short-term debt on its books, an amount greater than ten percent of its net income.[33] Exh. BSG-AG-1-16. If the Department excludes short-term debt from the capital structure, it should also exclude from return on equity calculations the short-term debt in excess of that amount needed for gas expense working capital. The Department, then, should include short-term debt in the Company's capital structure used to determine the return on rate base to be included in the cost of service.

2. Cost of Common Equity

The Company begins its brief on cost of common equity with a request for the SIR adjustment mechanism, claiming it will send the right signal to the investment community. Co.

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[32] The Company argues that its proposed rate base equals the capital structure without short-term debt, and therefore the exclusion of short-term debt is appropriate. Co. I. Br., p. 194. The argument incorrectly assumes that the Department can trace funds to particular uses.

[33] The test year interest can be calculated by multiplying the average interest rate of 1.94 percent times the amount of short-term debt amount of $153 million. [3 million = $153 million x 0.0194]. Exh. BSG-AG-1-16 .

I. Br., pp. 199-200. The approval of the SIR adjustment mechanism in this case, however, will only:

- Increase the Department's administrative oversight requirements and costs, not only for Bay State Gas, but also for all of the gas, electric, and water utilities under its jurisdiction that will seek similar pass through clauses for all of their capital additions;

- Allow more than 83 percent of a utility's costs to be passed through dollar for dollar with the remaining costs recovered with annual inflation increases through the price cap formula;

- Remove all incentives for utilities to reduce costs and become more efficient; and

- Artificially increase rates, further depressing the Massachusetts economy.

The Department should reject the Company's proposed SIR mechanism because of these problems and because the annual price cap increases will more than compensate the Company for its capital additions.

The Company asserts that the recommendation by the Attorney General's cost of capital witness, Mr. Newhard, on the cost of common equity does not meet Mr. Moul's expectations of increasing capital cost rates. Co. I. Br., pp. 206-207. The Company is wrong for several reasons. First, investors' expectations of increasing capital cost rates, to the extent they exist, are already subsumed in the price they are willing to pay for the stock. Tr. 24, pp. 3960-3964. Second, the price cap formula will compensation the Company for increases in the rate of inflation during the term of the PBR Plan. *Id*. Finally, the fact that the recommended 8.66 percent allowed return on common equity does not equal the forecast of one analyst -- Value Line Investment Survey's higher returns for next year can be expected. As the Department recognizes, the actual return on common equity in any given year or group of years will not necessarily equal the investors' cost of equity. *Berkshire Gas Company*, D.P.U. 905, pp. 48-49 (1982) *citing Boston Edison Company*, D.P.U. 1991, p. 56 (1979). The higher allowed returns on common equity from other state commissions (1) are all more than a year old, and (2) fail to recognize the fact that the Company will dramatically lower its risk and required return with its proposed Price Cap type PBR rate plan, Pension and PBOPs adjustment mechanism, and SIR adjustment mechanism. Exh. AG-8, pp. 17-18.

The Company makes two arguments concerning Mr. Newhard's constant growth rate Discounted Cash Flow analysis. Co. I. Br., pp. 209-210. First, the Company argues that the use of the forecasted growth from retained earnings understates the DCF growth rate because it uses year end common equity in the calculation. *Id.* As Mr. Newhard testified, Value Line is forecasting a growth rate from a period and using that rate rather than Mr. Moul's calculations. Tr. 24, p. 3965. Second, the Company's selection, without any basis, of Value Line's forecasted growth in book value per share as **the** appropriate DCF growth rate biases the DCF results upward. Co. Br., p. 210. Mr. Newhard, however, described the drawbacks to dividends, earnings, and book value per share growth rates, and the reasons that the growth from retained earnings is superior to those other measures. Exh. AG-8, pp. 9-14.

The Company's arguments regarding Mr. Newhard's two-step DCF analysis are also without merit. Co. I. Br., pp. 211-212. First, the Company argues that he did not use the Value Line Investment Survey as his growth rate estimate for the first step of the analysis. *Id.* As Mr. Newhard stated, however, he attempted to capture the greatest number of investors possible by using analyst surveys rather that the expectation of any individual analyst as the Company suggests in using Value Line by itself. Tr. 24, pp. 3966-3967. Furthermore, using Value Line estimates in the two-step analysis would have prevented the constant growth rate DCF and the two step DCF analyses from being independent of each other. *Id*.

Second, the Company criticizes Mr. Newhard for using the forecasted growth in the Gross Domestic Product as investors' long-run growth rate after the first step, recommending the use of the growth rate in the corporate earnings. *Id*. As Mr. Newhard testified, however, investors do not expect utilities, including gas utilities, to grow as fast as the rest of the corporate world. Rather they are considered to be low risk, low growth businesses. *Id.,* pp. 3967-3970.

The Company also claims that Mr. Newhard's analysis somehow leaves out one-half of a year in growth in the first step of the growth rate analysis, based on Mr. Moul's testimony. Co. I. Br., pp. 211-212. Mr. Moul, however, did not find any problems with the theory or the equation. Tr. 22, pp. 3749-3750.[34]

Mr. Newhard also demonstrated that the Company's proposed rate recovery mechanisms will allow the Company to recover more than 83 percent of its costs on a dollar for dollar basis, with the remainder collected with annual increases of based on inflation. Exh. BSG-AG-1-34. The Company responds by claiming that it will recover only 65 percent of its cost on a dollar for dollar basis if all of its proposed tariffs are approved. Co. I. Br., p. 212 *citing* Exh.

[34] Mr. Moul's assertion of an error with Mr. Newhard's discounted cash flows is itself erroneous. Mr. Moul proposes that the a correct two-step analysis for the comparison group would have a result of 9.39 percent. *Id*. This number and its calculation, however, are not found in his workpapers. *See* Exh. RR-AG-97(A). Furthermore, a simple check of his result, that would bound it, can be performed by adding the long-term growth rate of 5.57 percent to the dividend yield of 3.62 percent times one plus the short-term growth rate of 5.57 percent. However, that results in a return rate of just 9.39 percent ***which assumes that the short term growth rate is the same as the of 5.57 percent.***, when the two-step Mr. Newhard used had a 5.00 percent short-term growth rate. [9.39 = 3.62 x (1 + 0.0557) + 0.0557] Exh. AG-8, pp. 15-16, Exh. BSG-AG-1-25.

BSG/Rebuttal-3, pp. 21-22. The Company fails, however, to include its capital costs, those that are in the test year end rate base as well as the capital additions that the Company will recover through its SIR adjustment. *Id*. Since the test year end rate base is a sunk depreciating cost, the required return on that sunk rate base will also decrease over time. Thus, with the test year end rate base in base rates which has costs declining and full recovery of future capital costs under the SIR adjustment mechanism, the Company will recover 83 percent of its costs dollar for dollar through its proposed rate mechanism. Exh. BSG-AG-1-34.

3. The Company's Management Performance Merits Setting Return On Equity At The Lowest End Of The Range Of Reasonableness And The Imposition Of A Management Audit

The Attorney General supports the recommendations of Local 273 of the United Workers Union of America's ("Local 273") to set the Bay State rate of return at the low end of reasonableness for subpar performance, and for an independent audit to investigate the performance of management. Local 273 I. Br., pp. 16-41, 59. To the list of items for investigation proposed by Local 273, the Department should add item (iv), a review of reasons for the deferral of bare steel main replacements in the Brockton Service territory during the NiSource merger rate freeze, and (v) an accounting of the funds for mains and services infrastructure improvement provided to the Company through the settlement with the Attorney General in D.T.E. 97-97. The detailed list of management failures outlined by Local 273 also extend to the Company's failure: a) to ensure compliance with its own Operations and Maintenance ("O&M") manual, b) to follow Department precedent concerning appropriate back fill materials on repaired mains, c) to update its system maps, and d) to provide adequate regulatory support during the discovery phase of this proceeding.

a. Failure to follow O&M manual

Although Bay State "think[s the] O&M manual's requirements meet code," RR-AG-20(c), p. 3 of 24, it has disregarded important requirements of this manual for corrosion monitoring. For example, the Company does not appear to comply with the requirement of Procedure 7.8 for measuring corrosion pit depth on exposed pipe. Exh. AG-6-1, Procedure 7.8, §C; Tr. 17, pp. 2734-2735 (failure to measure pit depth during expert inspection); Exh. AG-2-1 (August 19, 2005) Attachments 2 & 3 (numerous 2004 leak report forms noting corrosion related repairs, but many not recording pit depth along adjacent pipe). According to the Attorney General's corrosion expert, Mr. Cavallo, this requirement of the manual is important because it would let a corrosion engineer understand what is happening to the Company's buried mains. Tr. 17, p. 2735. This information could assist in the creation of an appropriate main replacement program based on the sections of main deteriorating the fastest, *see generally* RR-DTE-117, Attachments 9 & 10, but the Company has chosen not to track this critical information.[35]

Bay State also does not follow its own O&M Manual for providing appropriate bedding and initial backfill around main leak repair sites. Exh. AG-7, p. 15-16; Tr. 17, pp. 2735-2736. At the two leak excavations, Mr. Cavallo observed that "backfill removed and replaced in the excavations contained both large and small stones, round and sharp, which had probably been in contact with the affected pipes before excavation and would, in all probability, come in contact again with the pipe after repairs were completed." Exh. AG-7, p. 15-16; Exh. AG-7, JRC-1 to JRC-8. "When asked at both sites if this backfill procedure was a typical example of Company

[35] Although the Company's O&M manual required measuring pit depth and designating deteriorated or damaged pipe "as a candidate for replacement and prioritization" "according to a point system in [its] bare steel replacement database," the Company claims not to have used this system, T. 23, p. 3913, and formally abolished it after the Attorney General sought information on the program. RR-AG-101.

work, Mr. Cote confirmed that it was." Exh. AG-7, p. 16. The Company's O&M Manual would not permit stones larger than ½" in the material next to the pipe. *Id.* pp. 15-16*, citing* Exh. AG-6-1, O&M Manual, § 4.05 (Trench Padding and Backfilling Procedure For Mains),and §10.3 (Pipe Bedding and Final Backfilling – Material Standards) ("For 6" and smaller pipe, maximum particle size should be ½"). This requirement makes intuitive sense, as Mr. Cavallo notes: "I am aware of no coatings manufacturer that recommends the placement of stones or other debris that may damage the coating against the surface of a coated buried steel pipe." Exh. AG-7, p. 16.

b. Failure to comply with Department backfill requirements

Although Bay State argued that its O&M Manual requirements for clean bedding and backfill applied only to new main installation, TR. 22, p. 3685, it offered no explanation for how its practice of simply reburying large and small stones against repaired mains complies with the Departments requirements for appropriate backfill material. *Investigation By The Department Of Telecommunications And Energy Upon its own motion Commencing A Review Of Standards Employed By Public Utility Operators When Restoring Municipal Street Surfaces After Performing Excavations*, D.T.E. 98-22 (1999). According to the standards attached to this order, "suitable backfill material is free of stones larger than half the size of the compacted lift", *Id*., §8.7.2, and the lifts[36] for maintenance shall be 6", *Id*., § 8.12.8, equaling a stone diameter not to exceed 3" in the backfill. Furthermore, the "bottom of the excavation shall be level, free of stones . . .."Id., §8.12.4. Bay State did not comply with these requirements at the two typical excavation and repair sites observed and photographed by Mr. Cavallo. Exh. AG-7, p. 15-16;

[36] A "lift" is the material placed back into the trench in layers before compaction. D.T.E. 98-22, §8.12.6.

Exh. AG-7, JRC-4 (original fill containing stones pushed back into excavation by backhoe), JRC-5 (fill containing stones compacted onto pipe after repair), JRC-6 (large stone in close proximity to pipe), JRC-8 (numerous stones in fill from excavation – later re-deposited in excavation and compacted).

c. Failure to update its system maps

The Company maintains system maps of its buried distribution mains, but these maps lack detail about the type of pipe coating and whether a coated pipe has cathodic protection. Tr. 24, pp. 3952 - 3954 (current system map does not show cathodic protection on pipe installed in 1961). Coated pipes have been in service starting approximately fifty years ago, and the different coatings applied can perform very differently in terms of how well they protect the steel surface of a pipe from corrosion. Tr. 2, pp. 287-288. Neglecting to mark the system maps with the type of coating material for decades, as well as whether a main has been installed or retrofitted with cathodic protection, hampers the ability to identify main segments that present a higher corrosion risk. Knowing which segments have a poor type of coating would help the Company target those areas for replacement earlier, rather than later. A review of the 2004 budget materials provided to R. J. Rudden reveals a potential source for the out-of-date maps: the Company apparently did not dedicated funds for updating maps. Exh. AG-14-9(c), Disk B, file 28, “DR Backup – Brockton Activity Based Budget mdm.xls”, Tab “Summary”, Activity 0119, Updating Maps (no funding for updating system maps 2004 budgeting). Out-of-date system maps hinder the ability of management to efficiently and safely operate the distribution system, and is not a hallmark of a well-run, safety-minded gas utility.

d. Failure to provide adequate regulatory support during discovery

The Department has held that a utility's failure to provide regulatory support during a proceeding is grounds for setting the return on common equity on the low end of reasonableness. *Fitchburg Gas and Electric Light Co.*, D.T.E. 02-24/25, p. 231 (2002). Local 273 I. Br., p. 16. By presenting a complex rate case with a new and controversial $300 million SIR adjustment plan, pension mechanism, new depreciation studies, a PBR plan and pending outsourcing of local jobs, the Company's management should have been prepared to handle discovery commensurate with the breadth and scope of its regulatory requests. Instead, its management's responses generally involved undue delays, even after directed to produce and identify documents by the Department, Tr., pp. 32-35 (June 2, 2005, procedural conference), and even after the Attorney General filed motions to compel.[37] Local 273 I. Br., pp. 8-16. The inevitable result was inadequate time and ability on the part of the Department and the intervenors to examine information and make the best decision on behalf of ratepayers. As rate cases become ever more complex with the invention of new reconciling mechanisms and special cost recovery tariffs, management's inability or unwillingness to fully cooperate with the discovery phase of the proceeding should result in a low-end rate of return.

V. SERVICE QUALITY

The Company claims that this rate case is not the appropriate forum for the Department

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[37] Pursuant to 220 C.M.R. § 1.10(3), the Attorney General requests that the Department incorporate the following documents by reference: May 17, 2005, letter to R. Dewees (discussing Company's reluctance to answer the Attorney General IRs sets one and two served promptly after initial filing); June 5, 2005, letter from P. French (inadequately identifying locations of responsive documents and failing to disclose the availability of system maps in electronic CAD files); June 15, 2005, motion to compel of Attorney General (requesting reports related to corrosion); June 21, 2005, opposition of Company to motion to compel (claiming documents do not exist); June 22, 2005, motion for leave to supplement motion to compel (noting Company claims requested documents do not exist after nonetheless inviting Attorney General to search several field offices for them).

to make findings on the Company's service quality because there is a pending generic investigation into service quality in docket D.T.E. 04-116.[38] Co. I. Br., p. 23. This position is not consistent with Department precedent and the legal requirements for setting rates. Not only is this docket the appropriate place for the Department to examine the Company's record on service quality and staffing levels in this case, but it is required to address the Company's past performance in setting rates.

The quality of service provided by a utility company is an integral element in setting its base rates. The Bay State has had many problems with maintaining service quality at the Springfield call center and maintaining gas safety and reliability through leak management. *See* Tr. 1, p. 65, 67-68; Tr. 16, pp. 2612-13, 2662-63. The Department must investigate this behavior because it is required to provide a return that:

> . . . should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under **efficient and economical management**, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

Bluefield Waterworks & Improvement Company v. Public Service Commission of West Virginia, 262 U.S. 679, 693 (1923) (emphasis added). There is "reasonable rate" for service that is deficient. The Department has recognized that customers are entitled to reasonable service in exchange for paying rates. *Cambridge Electric Light Company*, D.P.U. 92-250, p. 161-162 (1993); *Boston Edison Company*, D.P.U. 85-261-A/266-A, p. 14, 272 (1986). ("The Department has on numerous occasions set utility returns on equity at the low end of a range of reasonability

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[38] The Company suggests that the issues of service quality and staffing levels be addressed in the open docket D.T.E. 04-116. Co. I. Br., p. 23. When the Department recently held two days of technical sessions, open to all stakeholders, to discuss the redrafting the service quality guidelines, however, Bay State was notably absent.

when the utility's performance had been deficient."); *See also West Stockbridge Water Company*, D.P.U. 11891 (1957) (The Department has conditioned rate increases on utilities making specific improvements with respect to their supply and distribution systems.)

The Department, therefore, should investigate and audit both the Company's management activities with respect to main replacement and its service quality findings. AG I. Br., pp. 121-125.

VI. ADDITIONAL RATE CASE ISSUES

A. KEYSPAN MAY NOT USE THE BAY STATE HEARING TO SEEK RELIEF ON THE BAD DEBT ISSUE

KeySpan Energy Delivery New England ("KeySpan") correctly notes that the available options for it to attempt recovery for changes in Department precedent "are not subject to determination in this case." KeySpan I. Br., p. 16.[39] Although KeySpan has made arguments for two methods of recovery, the Department should not consider them here and instead notice a proceeding on KeySpan's September 16, 2005, PBR Adjustment filing to address this complex issue.[40] KeySpan's request for a change in the way the Department calculates KeySpan's bad debt expense would change its CGA formula. Changes to the formula of a reconciling tariff that

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[39] *But see* Exh. KED-1, p.3 ([T]he purpose of my testimony in this proceeding is to . . . request that the [KeySpan] be allowed to adopt the Bay State proposal, if approved by the Department in this proceeding.").

[40] In its PBR Filing, KeySpan has elected to recover for a change in the way it calculates bad debt expense as an exogenous cost under its PBR plan. These costs do not qualify as an exogenous factor in KeySpan's favor. First, KeySpan already set its CGA formula in D.T.E. 03-40, and did not appeal that decision in an attempt to change the way the Department required it to calculate bad debt expense. Waiving its rights to appeal the issue in 2003, KeySpan now seeks to revise that decision in the Bay State proceeding. Second, the increase in commodity price of gas that drives the costs of bad debt expense higher are not unique to the local gas distribution industry, but affect the economy in general so are reflected in the GDP-PI. *See also NSTAR*, D.T.E. 04-47, pp. 32-33 (2003) (increased pension expense does not qualify as an exogenous cost because market volatility effects all industries, not just electric and gas). The Attorney General reserves his rights to more fully elaborate on these arguments in the PBR adjustment proceeding.

increase rates must be subject to a hearing before the Department under G. L. c., 164, § 94, to set just and reasonable rates. *Consumers Organization For Fair Energy Equity, Inc. v. D.P.U.,* 368 Mass. 599, 606 (1975) ("[fuel tariff] clauses were designed precisely to avoid [§94] proceedings ***except where changes were being proposed in the clauses themselves***) (emphasis added). Due process requires that the customers in KeySpan's Boston Gas Company service territory, not the customers of Bay State, receive public notice of the proceeding.

KeySpan's conclusion that a finding for Bay State's position on the bad debt issue would necessarily apply to any other utility beside Bay State is erroneous. KeySpan I. Br., p. 18. The Department should not accept KeySpan's invitation to improperly expand the scope of this proceeding, but should defer issuing a decision on this issue and address it in the appropriate proceeding applicable specifically to KeySpan.

B. THE COMPANY'S ENERGY EFFICIENCY ADJUSTMENT MUST BE MODIFIED

In his initial brief the Attorney General reserved his right to comment on the propriety of the Company's proposal to incorporate an energy efficiency adjustment into its PBR formula pending the Company's response to the Department's request (DTE-RR-125) that the Company confer with the parties that participated in the settlement of the Company's most recent Energy Efficiency Program case, D.T.E. 04-39.[41] AG I. Br., p. 51. The Company has not indicated in either its response to the DTE's request or in its Initial Brief that it intends to modify its originally filed proposal or that it has conferred with the settling parties regarding this issue as the Department required. The Department should not approve the Company's proposal without

[41] The Company's response to DTE-RR-125, dated August 26, 2005, states that the Company was in the process of arranging to discuss the issue with the two settling parties. The Company in its initial brief does not address the outcome of any discussions with the settling parties or if such discussions have taken place. Co. I. Br., pp. 64-65.

a formal amendment to the settlement agreement.[42] When one party acts unilaterally to contravene specific terms of a settlement, it may render the settlement invalid and harm the interests of one or more of the parties.

If the parties agree to eliminate the recovery of lost base revenues ("LBRs") through the conservation component of the Company's LDAC,[43] and to incorporate the equivalent cost recovery in the PBR rate adjustments as proposed, the Department should address several issues related to the Company's proposal as filed.

Currently the Company recovers LBRs through a uniform cents per therm rate for each class. The Company proposes to adjust individual rate components (head block rate, tail block rate and demand charge rates) to recover lost therm sales revenues related to energy efficiency program installations. Exh. BSG-JAF-3, Sch. BSG/JAF-3-1, pp. 3-647-648. This change in recovery method will produce intra-class bill impact differences compared to the current recovery method that may adversely affect the energy efficiency goals and desired price signals that settling parties had bargained for or that the Department has relied upon in approving the Company's energy efficiency programs in the past.[44] The Department should require the Company to analyze the bill impact differences and provide an analysis of the potential affects the rate changes may have on the economics of the energy efficiency programs eligible for lost

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[42] The Department, through its appointed settlement staff, is a settlement signatory. *Bay State Gas Company*, D.T.E. 04-39, Settlement, p. 1.

[43] The local distribution adjustment clause (LDAC) is a full reconciling rate mechanism that allows gas utilities to recover costs (or flow credits to customers) that are distribution related but are not included in base rates. *Colonial Gas Company*, D.T.E. 98-128, p. 54 (1998).

[44] According to the terms of the settlement, not all energy efficiency programs are eligible for recovery of LBRs. *Bay State Gas Company*, D.T.E. 04-39, Settlement, p. 10. The Company's proposed ABRAM tariff that governs the PBR, energy efficiency and SIR rate adjustments, does not specify which approved energy efficiency measures would be included in the adjustment. Exh. BSG/JAF-3, Sch. BSG/JAF-3-1, p. 3-360.

base revenue recovery.

The combined affect of the energy efficiency adjustment and the annual PBR inflation of that adjustment will produce revenues in excess of those the Company would be entitled to under the rolling period method of LBR recovery required by the terms of the settlement. *Bay State Gas Company*, D.T.E. 04-39, Settlement, pp. 10-11; Exh. BSG/JAF-3, Sch. BSG/JAF-3-1, pp. 3-647-648 (Rate Adjustment Table, Note 1). The rolling period method allows the recovery of lost revenues only for the number of years between base rate cases where new bill determinants that reflect energy efficiency program sales reductions are used to establish rates–"Once a utility completes a rate case, that utility's LBR is reduced to zero." *Colonial Gas Company*, D.T.E. 97-112, p. 10 (1999). An annual PBR is, effectively, an annual base rate that adjust prices and reflects the prior year's actual sales–sales that include the effects of energy efficiency measures. If the Company and the settling parties agree to modify the terms of the settlement to allow an energy efficiency adjustment to be part of the PBR, the Department should require the Company to provide, as part of the annual PBR filing, proof that demonstrates that there is no such over recovery and modify the PBR tariff to require such a report in addition to all documentation supporting the therm savings used in the calculations.[45]

C. Bay State's Rate Case Discovery Proposal Is Inappropriate

The Company claims it could not reasonably have anticipated the complexity of this rate case or the amount of discovery required. Co. I. Br., p. 97. The Company suggests that the Department should limit the number of questions and the type of questions asked in the future,

[45] The energy efficiency adjustment to the individual rate elements should be reversed in the subsequent years to eliminate the over recovery.

similar to federal or state civil practice. *Id.* The Department should not allow the Company's proposal to limit discovery because it impermissibly limits the ability of the Attorney General and intervenors as parties to examine each element of the Company's rate increase request. Ch. 30A, § 11(3). Only the Legislature or a judicial decree can change the APA requirements.[46] If the Company believes discovery is overly burdensome or irrelevant, then it has a remedy and can file an objection. That process works well and no change is needed in the discovery procedure.

VII. CONCLUSION

WHEREFORE, for all of the foregoing reasons, the Attorney General requests that the Department reject the Company's proposed SIR program, pension and PBOP adjustment

[46] Limiting questions by intervenors would increase dramatically the burden on the Department because the intervenors provide valuable assistance in reviewing the case. For example, the Attorney General persisted in his efforts to discover the costs of the IBM contract, including a cost/benefit analysis and an examination of the costs of terminating the IBM contract. The Company initially resisted the AG's efforts, citing it as irrelevant to the proceeding. The Department correctly permitted the discovery, which revealed enormous financial penalties that would occur if the Company terminates the IBM contract prior to completion. RR-AG-10.

mechanism, PBR plan and rate increase and otherwise direct the Company to comply with the Attorney General's recommendations contained in his Brief and this Reply Brief.

Respectfully submitted,

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Dated: September 26, 2005

VIII. ATTACHMENTS AND SCHEDULES

Attachment A

September 21, 2005, Boston Globe article re: Bay State's CGA costs